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SUBJECT: GAZPROM'S THREATS A PLOY FOR STRENGTHENING UNION?

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¶1. (U) Summary: Gazprom and Minsk have been arguing for years over control of the GOB's Beltransgaz pipeline network. To date Lukashenko has fended off Russian attempts to take over the company, and at the same time has secured rock-bottom natural gas prices for his country-one of the main factors keeping Lukashenko's unreformed economy afloat. In late March and early April Gazprom initiated the latest campaign to take over Beltransgaz, by announcing that gas prices for Belarus would rise to nearly world prices in 2007, a 3 to 5 fold increase. The GOB has until the end of April to present a counteroffer. So far the GOB has suggested a number of economically questionable joint ventures with Gazprom, but has not publicly offered to sell Beltransgaz. An independent reporter who claims inside sources in the GOB stated the GOB is not overly worried, believing Gazprom will not follow through on threats to sharply raise gas prices. Instead, she opined that Moscow is using this issue to finally force Minsk into
a stronger union state. End summary.

Cheap Gas, the Back Story

¶2. (U) In a sweetheart deal that looks likely to be ending, Belarus buys natural gas from Russia's Gazprom for USD 46.68 per thousand cubic meters (tcm) (reftel). Belarus has in recent years avoided the gas increases faced by other former Soviet states partially because the GOB agreed in April 2002 to create a joint venture with Gazprom out of Belarus' state-owned pipeline company Beltransgaz. This joint venture was to have been created by July 2004, but no progress has been made because the GOB refuses to sell a majority stake in the company and because the GOB and Gazprom disagree on Beltransgaz's value; the GOB claims the company is worth USD 5 billion, while Gazprom insists it is only worth USD 600 million.

Gazprom Demands European Prices

¶3. (U) On March 30, in a meeting with Belarusian Energy Minister Aleksandr Ageev and Beltransgaz director Dmitry Kazakov, Gazprom CEO Alexey Miller announced that in 2007 Gazprom would raise gas prices for Belarus to European levels. He did not name a price, but some analysts have stated this means up to USD 235/tcm (Belarus currently pays USD 46.68/tcm.) Miller gave Minsk until the end of April to present a plan to Gazprom on how to raise these gas prices,

which presumably means Gazprom is waiting to see Minsk's counteroffer. On March 31, Gazprom's deputy CEO Andrey Kruglov told reporters in Belarus that, "By June we should be able to understand what the relations between Gazprom and Beltransgaz will look like." Russia's Ambassador to Belarus, Aleksandr Surikov, tried to soften the blow when he told reporters on March 31 that they should not dramatize this story, that Gazprom was simply opening negotiations on gas prices and was waiting for Belarus' counter-offer. Surikov claimed Russia had to raise gas
prices to meet its WTO obligations. However, on April 4, Gazprom deputy Aleksandr Ryazanov told the press Gazprom would triple gas prices for Belarus in 2007.

¶4. (U) On March 28, an anonymous GOB source told Prime-Tass that the GOB's goal is to agree to a gas price equivalent to that paid by Russia's ninth price belt (the Smolensk region currently around USD 42). This source also stated that any decisions on privatizing Beltransgaz would depend on Gazprom offering a favorable price for gas. On March 31, Beltransgaz director Kazakov announced, "It would be incorrect to speak about the sale of Beltransgaz. We are not talking about the sale, we are talking about the development of gas transport facilities of the two countries." He added that Belarus is ready to face gradual increases in gas prices, claiming Belarus deserves only mild increases because it is Russia's Union State partner, but complained that any sharp price rise would result in bankruptcy for many Belarusian firms. Several sources, including independent economist Leonid Zaiko, have told the press that any price above USD 80/tcm would result in the bankruptcy of at least one-third of Belarusian ent
erprises and the failure of many of the GOB's social assistance programs.

Rumors of a Deal Gone Sour?

¶5. (C) On March 30, Associated Press reporter Yaras Karamanov told Poloff he heard that Lukashenko had earlier offered Russia a controlling stake in Beltransgaz in exchange for Russian support during the March presidential election. Gazprom waited ten days after the election for the GOB to announce this sale. When no announcement was made, Gazprom therefore started making public statements of price increases to pressure the GOB. Independent economists Yaroslav Romanchuk and Elena Rakova separately told Econoff in the weeks before the election that the GOB was under heavy Russian pressure to sell Beltransgaz, and that Belarus' Council of Ministers was meeting daily to discuss how to handle this pressure.

GOB Counter Offers

¶6. (U) As a preliminary counter offer, on March 31 Energy Minister Ageev announced five joint projects the GOB will ask Gazprom to participate in, presumably for cheaper gas. The press has reported four of these projects:

1) The on-going upgrades to Gazprom's Yamal-Europa (YE) pipeline. The GOB will complete the last two compressor stations in Belarus in mid-2006, bringing YE's throughput capacity to 33 billion cubic meters per year. Ageev claimed the GOB gave Gazprom USD 200 million in tax and duty preferences and another USD 20 million in unspecified benefits for these stations.

2) Construction of a second YE pipeline, which Ageev claimed would save Gazprom USD 480 million compared to building the North European Pipeline. (Note: the infrastructure and

compressor stations for YE1 were built with the capacity to handle a second pipeline.)

3) Construction of a 450 megawatt power plant on the Polish border, worth USD 500 million, designed to export electricity to Europe. Ageev said this plant would require one billion cubic meters of gas annually.

4) Ageev also invited Gazprom to invest USD 1.05 billion in Grodno Azot, a Belarusian chemical company. Ageev offered to barter Azot-produced carbamide for Gazprom gas.

Gazprom's Threat a Ploy for Stronger Union?

¶7. (C) On April 4, Econoff met with Tatyana Manenok, energy reporter for independent newspaper Belarusy i Rynok (Belarusians and the Market). She claims to have strong contacts within the GOB. (Note: GOB officials have regularly refused to speak about energy issues with Emboffs.) Manenok opined that Gazprom's threats are not economically motivated, but are conversely intended to ensure Belarus remains in Russia's zone of control. The GOB knows that Gazprom will not raise prices until 2007, as there is a signed contract for this year. Moscow is simply using this moment, after the elections and when Lukashenko is under pressure from the West, to try and push Lukashenko into a more rigorous union state so as to secure Russia's western border against NATO as well as to finally force Minsk to accept currency union. She explained Moscow is also pushing Minsk on the Union State Constitutional Act, and that Putin and Lukashenko may meet in May to sign some sort of union agreement. To a lesser extent, she said
Moscow is also acting tough against Belarus to show off to the West in advance of the G-8 summit.

¶8. (C) At worst, Manenok said her GOB contacts believe Russia will raise gas prices a little bit, but that there is no threat of a sharp price jump. Therefore, many in the GOB discount the recent Gazprom threats. (Note: Despite this information, Manenok recently wrote that her contacts in the GOB believe Gazprom will raise prices to USD 100/tcm if Minsk does not privatize Beltransgaz.) The GOB also plans to fight to keep Beltransgaz, realizing that after any sale Belarus would have no more bargaining chips and nothing would stop Gazprom from raising gas prices.

A Sale is for the Best, Eventually

¶9. (C) According to Manenok, Beltransgaz's staff want their company to be at least partially privatized, and support Gazprom buying a 50% share. However, in 2005 Lukashenko replaced the director of Beltransgaz and the Minister of Energy with his supporters from the Presidential Administration (Kazakov and Ageev respectively). These two are afraid to make any decisions without permission from Lukashenko himself. The company's staff do not see any signs their company will be sold in the near future, but she speculated that a sale is possible towards the end of 2006, as the current gas contract nears completion.

"Cheap Energy and Fear"

¶10. (C) Manenok stated that Belarus is making itself more susceptible to Russian pressure. Lukashenko's policy of connecting every village to natural gas increases the country's dependence on Gazprom. Many officials in the GOB are also arguing that Belarus should raise the transit rates it charges for Gazprom gas. These rates remain very low and

have not changed for many years. Conversely, these same officials argue that Belarus should not pay more than Russia's ninth price belt price (USD 42), plus transit costs. Manenok also explained that Belarus is addicted to cheap Russian gas. Agreeing with Zaiko and others, she said that USD 80/tcm is Belarus' "point of zero return." If gas rose above that level, the GOB knows that at least half its enterprises would be unprofitable and the regime could not afford the social programs that keep Lukashenko popular. According to Manenok, "Cheap energy and fear keep this economy going."

Economics Not a Concern

¶11. (C) Manenok estimated that Gazprom does not need Beltransgaz's pipelines for economic reasons. She said that the new compressor stations on YE could easily handle any near-term increase in Europe's demand, and that in fact transit through Beltransgaz has been falling this year. (Note: the Ministry of Statistics reported gas transit through Beltransgaz fell 16.4% in the first two months of the year, while it rose 57.8% through YE.) As Europe also tries to diversify away from reliance on Russian gas, Manenok opined that Gazprom will not need to build YE2.

¶12. (C) As for the five proposals Ageev presented, Manenok said they are mainly for show, so the GOB can claim it is receiving something in return from Gazprom in case it is forced to give up Beltransgaz. She claimed that the GOB has not given any thought as to whether these projects are economically viable. For instance, Belarus currently sells some electricity to Poland. These sales are only profitable because the GOB uses cheap gas from Russia in its power stations. Any increase in gas prices would make electricity exports unfeasible, so a new 450 MW power plant makes no sense. She also did not understand why Gazprom would be interested in bartering gas for Azot's carbamide.

Comment

¶13. (C) The on-again, off-again battle between Gazprom and the GOB for control of Beltransgaz has been continuing for years. In February 2004 Gazprom even went so far as to cut off all gas to Belarus for a day. Supplies, however, were restored after Lukashenko outmaneuvered Moscow in the realm of public opinion (Lukashenko even called Putin a terrorist, with no apparent Russian retaliation). It is telling that Moscow is trying again to secure Beltransgaz, and is striking when Minsk is under sharp criticism from a united West over the recent undemocratic election. If Lukashenko has to accept a sharp increase in gas prices, the Belarusian economy will suffer a severe blow, and Lukashenko will lose one of his key pillars of support.
Krol